CBV Institute

CBV INSIGHTS

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VALUATION AND TAXES

Recent developments in the Canadian tax landscape and how they affect your business

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CBV INSIGHTS

About Chartered Business Valuators Institute (CBV Institute)

CBV Institute leads the Chartered Business Valuator (CBV) profession – Canada's only designation dedicated to business valuation since 1971. With CBVs and Students across Canada and around the world, we uphold the highest standards of business valuation practice through education, accreditation and governance of the CBV, for the benefit of the public interest.

CBV Insights

CBV Insights is a thought leadership periodical published by CBV Institute with the aim of sharing the expertise of Chartered Business Valuators with our network and the broader public. While the insights shared by contributing authors in CBV Insights are designed to inform and inspire, they do not necessarily carry the endorsement of CBV Institute and should not be construed as tax advice.

INTRODUCTION

Tax specialists and Chartered Business Valuators (CBVs) enjoy a symbiotic relationship because of the complex provisions of the *Income Tax Act*. CBVs who practice business valuations for tax purposes typically work with an array of tax specialists, including legal counsel, corporate accountants, family office advisors, estate and trust planners, and independent tax consultants. This cross-disciplinary collaboration ensures that Canadian taxpayers receive the most current and relevant information.

The landscape surrounding valuation for income tax purposes is always evolving due to tax law changes and recent court results. In this edition of CBV Insights, we will explore a few recent tax developments where valuation is at the forefront of the issue. Our goal is to highlight the importance of valuation considerations during tax planning, helping you safeguard your investments and reduce the risk of disputes with the CRA.

Key Topics Covered

1. **Lauria v. The Queen:** A Tax Court of Canada decision that underscores the importance of accurate and supportable valuations in share transfers.
2. **Capital Gains Inclusion Rate Increase:** A major change in the taxation of capital gains that has nuanced implications for individuals, corporations, trusts, estates, SMEs, and startups.
3. **Intergenerational Business Transfers – Bill C-208 & C-59 Amendments:** New rules impacting the transfer of family-owned businesses.

WHO ARE CBVs?

CBVs are accounting, finance and business professionals who have received extensive formal education and accreditation in business valuation from CBV Institute.[1]

The Institute awards the CBV designation to someone who has passed a rigorous set of courses and exams, and has obtained relevant experience in the field of business valuation. Accredited CBVs must adhere to CBV Institute's Code of Ethics and Practice Standards, including annual continuing professional development (CPD) requirements, and are subject to a mandatory practice inspection program.

CBVs have been providing specialized business valuation services in Canada and around the world for over 50 years, and work in a variety of roles – anywhere a conclusion of value is needed – including business advisory, litigation support, transactions, financial reporting, corporate finance, private investments, and corporate development. The list of CBV workplaces is extensive; it includes family offices, public accounting firms, private equity and venture capital firms, investment banks, tax authorities (e.g., CRA) and securities regulators.

LAURIA V. THE QUEEN

In *Lauria v. The Queen* (2021 TCC 66),[2] the Tax Court of Canada dealt with issues surrounding the valuation of shares transferred to family trusts before an Initial Public Offering (IPO). Almost 10 years beyond the normal reassessment period, the CRA reassessed the taxpayers due to what it deemed a misrepresentation of the shares' fair market value (FMV).

The role of CBVs in determining fair market value (FMV)

- The term fair market value (FMV) appears more than 1,000 times in the *Income Tax Act* but is not defined in the statute.
- Over time, Canadian tax courts have developed a definition of FMV based on case law.
- Importantly, FMV must be determined on a case-by-case basis, with the courts weighing all evidence presented.
- In many cases, the testimony and reports of expert witnesses are crucial.
- CBVs serve as expert witnesses to the courts when an independent opinion is needed regarding the FMV of a business or its assets. While engaged by one party to the legal proceeding, CBV expert witnesses are there to serve the court.
- Courts tend to prefer valuations that are well-supported by data, methodology, and logical reasoning, and they may reject valuations that appear speculative or biased. These are also essential requirements of the Professional Standards of CBV Institute.

CASE FACTS (IN PART)

- The taxpayers, Lauria and Freedman, were executives and shareholders of a wealth management firm, Gluskin Sheff + Associates Inc. ("GS+A").
- They sold GS+A shares to their respective family trusts shortly before GS+A filed a preliminary prospectus for an IPO.
- The taxpayers used a formula that appeared in their initial share purchase agreements to value the share transfers. The formula significantly undervalued the shares compared to the share prices fetched at the IPO, which provided an indication of FMV. The IPO took place approximately two months after the share transfer.
- The CRA reassessed the taxpayers beyond the normal reassessment period, alleging they misrepresented the value of the shares transferred to the trusts.
- The taxpayers argued that the reassessment was statute-barred[3] and that they had not misrepresented the value.
- The taxpayers did not produce an independent valuation report or valuation expert at trial.
- **Tax Court Decision:** The Tax Court of Canada agreed with the CRA, finding that the taxpayers undervalued the shares and that the misrepresentation allowed reassessment. The Court determined the FMV of the shares by relying on a CBV engaged by the CRA to serve as an expert witness, resulting in a significant increase in the assessed capital gains and the corresponding tax liability.
- **The Federal Court of Appeal Decision:** The Federal Court of Appeal *(Freedman v. Canada. 2023 FCA 81)*[4] upheld the decision made by the Tax Court of Canada.

KEY TAKEAWAYS

1. **Valuation:** The case highlights the importance of obtaining independent and accurate valuations for tax purposes, especially in transactions involving related parties or an imminent liquidity event. Taxpayers and their advisors must exercise due diligence in determining FMV to avoid potential reassessments and penalties.
2. **Timing of Transfers:** When dealing with reorganizations ahead of an imminent liquidity event (such as an IPO, sale of the business, or equity raise), the taxpayer should retain a valuation expert for income tax purposes and the expert should be fully informed as it may significantly impact the considerations for the FMV.
3. **A formula in a share purchase agreement may not be "FMV":** The share purchase agreement used a multiple of revenue as the valuation formula. However, the FMV decided by the court was close to 12 times higher than this formula value. While valuation formulas – often based on assets or multiples of revenue or earnings - may be acceptable to the parties involved in the transaction, they often fail to account for all the factors relevant to determining FMV.
4. **Misrepresentation:** The decision underscores the broad application of subsection 152(4) of the *Income Tax Act,* which allows the CRA to reassess tax returns beyond the normal reassessment period if there is a misrepresentation attributable to carelessness or neglect. This has significant implications for taxpayers, reinforcing the CRA's authority to challenge negligent transactions and potentially impose additional taxes and penalties.
5. **Estate Freeze Transactions:** Although the case specifically dealt with share transfers to family trusts, its principles have broader implications for estate freeze transactions, where assets are transferred to the next generation at a frozen value to minimize future tax liabilities. The case serves as a cautionary tale for taxpayers engaging in such transactions, emphasizing the need for early involvement of valuation professionals and careful planning to avoid potential adverse tax consequences.
6. **Penalties and Interest:** The decision also addressed the issue of penalties and interest for misrepresentation, highlighting the potential financial consequences for taxpayers who fail to report FMV accurately.

In summary, *Lauria v. The Queen* contributes to the existing jurisprudence on valuation. Lauria is an important reminder for taxpayers and tax professionals about the significance of accurate valuations, the potential consequences of misrepresentation, and the CRA's extended reach in reassessing tax returns. It underscores the importance of seeking professional valuation advice from independent CBVs and exercising due diligence in tax planning and reporting to ensure valuation compliance with the *Income Tax Act*.

CAPITAL GAINS INCLUSION RATE INCREASE

The 2024 Federal Budget introduced a significant change: the portion of capital gains included in taxable income has risen from 50% to 66.7% in certain circumstances, as outlined below. Effective June 25, 2024, this change has important implications for business owners.[5]

The role of CBVs in determining capital gains

- For complex transactions, such as corporate reorganizations, estate freezes, or sales involving earn-outs and contingent payments, a CBV may be engaged to ensure that the capital gain is accurately calculated. Their role is to analyze the specifics of the transaction, assess the value of the assets involved, and provide detailed reports that can withstand scrutiny by tax authorities.
- If the CRA disputes the declared value of an asset, and by extension the capital gain on disposition, a CBV may be involved in providing expert testimony or reports to support the taxpayer's position. Their valuation reports can be crucial evidence in tax court cases or during negotiations with the CRA. It is important to engage an independent CBV before the transaction is finalized as it becomes much more difficult to support the taxpayer's position after the fact.
- CBVs, alongside CPAs specializing in tax reorganizations, also advise clients on how to structure transactions to minimize capital gains taxes. By assessing the potential tax implications of different strategies, they help business owners make informed decisions that can optimize their tax positions.

KEY IMPACTS

- **Impact on Individuals:** Individuals will be afforded a $250,000 annual threshold. Gains up to $250,000 will continue to be included in taxable income at the previous rate of 50%. Capital gains exceeding this amount will be subject to a higher inclusion rate of 66.7%.
- **Impact on Corporations and Trusts:** There is no threshold of relief. The increased inclusion rate of 66.7% applies to all capital gains realized by corporations and most types of trusts.
- **Impact on Intergenerational Wealth Transfer:** Before this rate change was even contemplated, many business owners proactively engaged in estate planning by using estate freezes to lock in the amount of capital gains. However, due to the increase in the percentage of capital gains that are taxed, the final tax bill on an estate's assets could increase by up to 33.3%.[6]
- **Impact on Small and Medium-Sized Enterprises (SMEs):** The impact may be particularly significant for shareholders of SMEs. After claiming any remaining Lifetime Capital Gains Exemption (LCGE),[7] and using up the $250,000 individual threshold, sellers would face higher capital gain taxes than previously contemplated. As a result, some business owners are delaying the sale of their business (to benefit from healthy cash flows for a little while longer). But this tactic is not without risk, since the purchase price of a business can go up or down with changing economic and market conditions.
- **Impact on Startups and High-Growth Companies:** These businesses typically reinvest profits into growth rather than paying dividends. The higher capital gains inclusion rate could discourage investment in these companies, as the net present value of future gains is reduced while the risk remains the same. Investors may seek other investment opportunities with lower tax burdens. This could lead to lower valuations for startups and high-growth companies.

SIMPLIFIED SHARE SALE EXAMPLE

In the following table, a simple share sale example illustrates the effect of change.[8] The FMV of the shares is $10M, and we assumed the shares qualify for the lifetime capital gain exemption (LCGE). In our example, the effective tax rate *increased* by 29%.[9] Depending on the amount of FMV and availability of LCGE, the range of increase is between 0% and 33%.[6]

	Before	After
Fair market value	10,000,000	10,000,000
Less: LCGE	(1,016,836)	(1,250,000)
Capital Gains	8,983,164	8,750,000
Top tax rate (Ontario)	26.76%	
On first $250K		26.76%
After $250K		35.68%
Taxes payable (rounded)	(2,404,000)	
On first $250K		(67,000)
After $250K		(3,033,000)
Total taxes payable	(2,404,000)	(3,100,000)
After-tax proceeds	7,596,000	6,900,000
Effective tax rate	24.0%	31.0%

COMPREHENSIVE ASSET SALE EXAMPLE

In a more comprehensive example, appearing on the next page, a variety of assets are to be disposed of within one fiscal year.

Primary assets in this example are land, buildings, intangible assets,[10] net working capital and equipment. The majority of the accrued and unrealized gain[11] is capital gain on investment and real estate and a small amount of recapture income.[12]

In our illustrative example, the estimated overall effective tax rate increased by 21%.[13] Depending on the mix of accrued gains in the corporation, the range of increase is between 0% and 33%.

KEY IMPACTS

1. **Valuation:** With a higher inclusion rate, business owners may face higher taxes on the sale of their businesses and capital assets, resulting in lower after-tax proceeds. While the exact impact on business valuations will vary depending on the specific circumstances of each business, a higher tax burden increases transaction costs, which may reduce economic activity.
2. **Preparing for a sale:** Business owners who are contemplating the sale of their business should consult with their accountant and valuator to properly plan for the sale and obtain an understanding of their expected proceeds net of taxes.

In summary, the increased capital gains inclusion rate of 66.7% has garnered significant attention from the business community for a reason. Business owners and investors should carefully consider the potential impact of this change and seek professional advice to understand how it may affect their specific situations.

ILLUSTRATION OF THE IMPACT ON TAXES DUE TO THE CAPITAL GAINS INCLUSION RATE CHANGE

Step 1: Calculation of the Amount of Investment Income, Capital Dividend Account (CDA), and Refundable Dividend Tax on Hand (RDTOH)

					Previous Capital Gain Inclusion Rate			New Capital Gain Inclusion Rate		
Sale of Corporate Assets	Cost	NBV	FMV	Business income (Recapture on CCA)	Investment income (Taxable Capital Gain)	CDA	RDTOH	Investment income (Taxable Capital Gain)	CDA	RDTOH
					50.0%	50.0%	30.67%	66.7%	33.33%	30.67%
Net working capital	100,000	100,000	100,000	-	-	-	-	-	-	-
Land	2,600,000	2,600,000	8,710,000	-	3,055,000	3,055,000	936,969	4,073,333	2,036,667	1,249,291
Building	400,000	300,000	800,000	100,000	200,000	200,000	61,340	266,667	133,333	81,787
Equipment	100,000	80,000	90,000	10,000	-	-	-	-	-	-
Intangible assets	-	-	1,000,000	-	500,000	500,000	153,350	666,667	333,333	204,467
Less: mortgage & liabilities	(500,000)	(500,000)	(500,000)	-	-	-	-	-	-	-
Total net assets	2,700,000	2,580,000	10,200,000	110,000	3,755,000	3,755,000	1,151,659	5,006,667	2,503,333	1,535,545
Tax rate (general / aggregate investment income)				26.5%	50.17%			50.17%		
Corporate taxes payable				**$29,150**	**$1,883,884**			**$2,511,845**		

Step 2: Calculation of the Combined Personal & Corporate Taxes and Effective Tax Rate

Distribution to Shareholder		Old Rule		New Rule	Change
Total net assets FMV (calculated in Step 1)		$10,200,000	A	$10,200,000	-
Less corporate taxes					
Tax on business income	Step 1	(29,150)		(29,150)	-
Tax on investment income	Step 1	(1,883,884)		(2,511,845)	(627,961)
Add: RDTOH refund	Step 1	1,151,659		1,535,545	383,886
Corporate taxes net of RDTOH		(761,375)	B	(1,005,450)	(244,075)
Net asset after corporate tax		9,438,625	A+B=C	9,194,550	(244,075)
Less: return of PUC (assumed)		(100)		(100)	-
Less: CDA (tax-free distribution to shareholder)	Step 1	(3,755,000)		(2,503,333)	1,251,667
Proceeds available to distribute as dividend		5,683,525		6,691,117	1,007,592
Dividend grossed-up (non-eligible)	15.0000%	6,536,054		7,694,784	1,158,730
Personal taxes (Ontario top marginal on non-eligible dividends)	53.5300%	(3,498,750)		(4,119,018)	(620,268)
Less: DTC on grossed-up dividends (Federal and Ontario combined)	12.0164%	785,398		924,636	139,238
Net personal tax		(2,713,351)	D	(3,194,382)	(481,031)
Net proceeds to shareholder (rounded)		$6,725,000	C+D=E	$6,000,000	-$725,000
Total Taxes (Corporate & Personal)		$3,475,000	A-E=F	$4,200,000	$725,000
Effective Tax Rate (Corporate & Personal)		34.1%	F/A	41.2%	7.1%

INTERGENERATIONAL BUSINESS TRANSFERS: NAVIGATING BILL C-208 & BILL C-59 AMENDMENTS

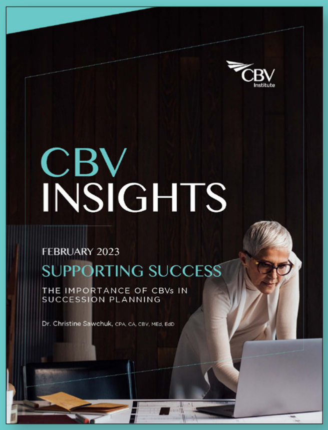
For business owners planning a transition to the next generation, Bill C-208 and Bill C-59 are critical legislative changes that directly affect the process.[14] These bills have changed the tax treatment of intergenerational transfers of family-owned businesses, making it essential for owners and their advisors to understand and navigate these regulations to ensure a smooth and tax-efficient succession.

RATIONALE OF BILL C-208

1. **Equitable Treatment:** Prior to Bill C-208, selling shares of a business to family members was often taxed at a higher rate than selling to a third party. More specifically, section 84.1 of the *Income Tax Act* recharacterized capital gains as dividends when non-share considerations (e.g. cash and promissory note) were received by corporate non-arm's length parties. Furthermore, the seller could not claim the lifetime capital gains exemption (LCGE). The combined effect discouraged intergenerational transfers due to tax considerations. Bill C-208 aimed to level the playing field with third-party sales by amending the *Income Tax Act* related to non-arm's length transactions. We illustrate the differences using an example of a $3M sale of business common shares as follows:

Non-arm's length Sale	Before Bill C-208	After Bill C-208	
The fair market value of shares	**$3,000,000**	**$3,000,000**	**A**
Less: LCGE	-	(1,250,000)[15]	
Non-eligible Dividends/Capital Gains	3,000,000	1,750,000	
Top tax rate (Ontario)			
Non-eligible Dividends	47.74%		
First $250K of Capital Gains		26.76%	
After $250K of Capital Gains		35.68%	
Personal Taxes payable (rounded)	**(1,432,000)**	**(602,000)**	**B**
After-tax proceeds	**$1,568,000**	**$2,398,000**	**A+B**
Effective tax rate	47.7%	20.1%[15]	B/A

2. **Preservation of Family Legacies:** Family businesses are the backbone of many communities, providing jobs and contributing to the local economy. By facilitating the transfer of these businesses to the next generation, Bill C-208 helps preserve family legacies and the positive impact on their communities.
3. **Economic Growth:** Encouraging the continuity of family businesses can contribute to economic growth and stability. When businesses stay within the family, they are more likely to maintain their roots in the community, continue employing local workers, and reinvest in the local economy.
4. **Retirement Planning:** For many business owners, their business is their primary asset and retirement plan. Bill C-208 helps ensure that they can sell their business to their children or grandchildren[17] without facing a significant tax burden.
5. **Simplified Succession Planning:** Bill C-208 simplifies the succession planning process for family businesses. By removing the tax disincentive for intergenerational transfers, it encourages business owners to start planning for the future of their business and ensures a smooth transition to the next generation.



The role of CBVs in succession planning

At a time when $2 trillion of business wealth is expected to change hands over the coming decade,[18] it is essential that succession planning is done in a responsible way as there are implications not only to the business owner and other individuals, but from a macroeconomic perspective as well.

For business owners, the challenge of understanding and estimating the value of their business is often a significant barrier preventing them from creating a formal succession plan, or even starting the process.

There is a huge opportunity for business owners to rely on CBVs to overcome this obstacle. Read more about the importance of CBVs in succession planning in CBV Institute's 2023 publication, Supporting Success.

THE BILL C-59 AMENDMENT AND THE IMPORTANCE OF FAIR MARKET VALUE

Bill C-59 was introduced to ensure that taxpayers do not misuse Bill C-208 for tax avoidance that undermines the equity of Canada's tax system. It came into effect on January 1, 2024.

FMV has always been a crucial consideration in intergenerational business transfer transactions. The revisions in Bill C-59 have only increased the importance of obtaining an accurate and supportable FMV determination.

KEY TAKEAWAYS

1. **FMV Tested Thresholds:** To qualify for intergenerational business transfers under Bill C-59, sellers can choose between two streams: Immediate Business Transfer or Gradual Business Transfer. While we don't delve into the technical details of each stream here, both require the vendor (the older generation) to gradually reduce their ownership in the company, allowing the next generation to take over. Notably, under the Gradual Business Transfer test, within 10 years after the initial sale, the vendor cannot own any debt or fixed-value equity interest in the company that exceeds 30% of the company's total FMV for qualified small business corporation shares, or 50% of the total FMV for shares of a family farm or fishing corporation. Accurate FMV determination by CBVs is crucial to ensure compliance with these thresholds.
2. **Creating Non-Voting Preferred Shares:** Under Bill C-59, the vendor (the older generation) cannot own more than a certain percentage of the company, except through non-voting preferred shares. The non-voting preferred shares are generally defined to be fixed value shares that are non-voting, non-convertible, and have a dividend entitlement that doesn't exceed a prescribed limit. Importantly, these preferred shares must be issued at a redemption amount equal to their FMV at the time of issuance. If shares are issued at an amount below or above FMV, the vendor risks disqualification from the stringent intergenerational transfer rules.
3. **General Test of Non-Arm's Length Transactions:** Under the intergenerational business transfer regulations, family members are considered to be transacting at non-arms' length. The *Income Tax Act*[19] generally penalizes non-arm's length parties who do not transact at FMV. If the sale price is below FMV, the CRA may challenge the transaction and reassess the taxes owed. In such cases, the buyer's adjusted cost base (ACB) will be the lower of the transaction amount or FMV, while the seller's proceeds will be deemed to be the higher of the two. This can result in double taxation for the family.

In summary, FMV is a critical element in intergenerational wealth transfer transactions. Providing support on the FMV of shares is essential for preserving capital gain treatment, complying with stringent tests, and ensuring the transaction represents a genuine transfer of business ownership.

GENERAL ANTI-AVOIDANCE RULE (GAAR)

Bill C-59 also introduced significant changes to the General Anti-Avoidance Rule (GAAR), aiming to strengthen its effectiveness in combating aggressive tax planning. These changes expand the CRA's ability to challenge tax avoidance schemes and impose penalties. The GAAR penalties are also based on FMV, again elevating the importance of obtaining an accurate and supportable calculation of FMV.

KEY CHANGES

1. **Lowered Threshold for Avoidance Transactions:** The new GAAR could apply to even more transactions. This is because the "primary purpose" test was replaced with a "one of the main purposes" test. The new test allows the CRA to classify a transaction as tax avoidance if obtaining a tax benefit is one of the main purposes, even if the transaction has other legitimate business purposes. This change applies retroactively to transactions occurring on or after January 1, 2024.
2. **Introduction of a GAAR Penalty:** A 25% penalty on the tax benefit obtained from an avoidance transaction was introduced, effective June 20, 2024.[20] If GAAR applies, the penalty is 25% of the amount of the increase in tax payable, which may well be based on the FMV of the business or its assets. In this situation, a CBV can provide an independent calculation of FMV.
3. **Extended Reassessment Period:** The normal reassessment period for transactions subject to the GAAR was extended by three years, effective January 1, 2024.

KEY TAKEAWAYS

1. **Extended Reach:** Taxpayers need to be more cautious in structuring transactions, as the GAAR now has a broader reach.
2. **Penalties for Non-compliance:** Obtaining professional tax advice is crucial to ensure compliance with the new rules and avoid potential penalties.
3. **Significance of FMV:** Obtaining professional valuation service is crucial to ensure FMV is appropriately assessed.
4. **Potential for Reassessment:** Voluntary disclosure may be a viable option for taxpayers who have engaged in past transactions that may be challenged under the new GAAR.

Overall, Bill C-59's GAAR changes signify a stronger stance by the Canadian government against aggressive tax planning. Taxpayers and their advisors must carefully consider the potential application of GAAR in all tax planning endeavours.

CONCLUSION

As the Canadian tax landscape continues to evolve, understanding the intricate relationship between taxation and business valuation is more crucial than ever. The recent changes discussed in this article highlight the need for business owners and advisors to involve a business valuation professional early in their strategic planning. Whether it is navigating new legislation, such as Bill C-208 and Bill C-59, or dealing with the impacts of the increased capital gains inclusion rate, the importance of accurate and defensible valuations cannot be overstated. By seeking expert advice from CBVs and tax professionals, you can better position your business to meet these challenges head-on, safeguard your assets, and ensure the long-term success of your enterprise.

NOTES

1. For more information, see: https://cbvinstitute.com/become-a-cbv/.
2. *Lauria v. The Queen,* 2021 TCC 66 (CanLII), <https://canlii.ca/t/jkgdz>, retrieved on 2024-08-23.
3. **Statute-barred:** A legal term indicating that the period in which legal action or reassessment can be initiated has expired.
4. *Freedman v. Canada,* 2023 FCA 81 (CanLII), <https://canlii.ca/t/jx02b>, retrieved on 2024-08-27.
5. At the time this article is published, the capital gain inclusion rate is yet to receive Royal Assent, and as such, the bill has not become law.
6. All else being equal, the increase in taxes is calculated as (66.7% / 50%) - 1 = 33.3%.
7. The $1,016,836 LCGE for sales of small business shares (or assets for fishers and farmers) increased to $1,250,000 as of June 25, 2024.
8. This simplified example omits many considerations, such as the general permitted deferral of capital gain from the disposition of capital property if the seller does not receive all the payment up front.
9. All else being equal, the increase in taxes is calculated as ((31% - 24%) / 24%) = 29%.
10. **Intangible Assets:** These are non-physical assets that have value, such as patents, trademarks, copyrights, goodwill and intellectual property. Unlike physical assets like land or equipment, intangible assets are often more challenging to value.
11. **Accrued and Unrealized Gain:** Accrued gain refers to the increase in the value of an asset that has occurred but has not yet been realized through a sale or other transaction. Unrealized gain is similar in that it represents the increase in value of an asset that has not yet been sold; the gain is ‘unrealized’ because the asset is still being held and has not yet generated a taxable event.
12. **Recapture Income:** This refers to the portion of the gain on the sale of a depreciable asset that is taxed as ordinary income rather than as a capital gain. It occurs when the asset is sold for more than its depreciated value.
13. All else being equal, the increase in taxes is calculated as ((41.2% - 34.1%) / 34.1%) = 21%.
14. Bill C-208, passed in 2021, was designed to facilitate the intergenerational wealth transfer of private businesses, family farms, and fishing corporations. Subsequent amendments under Bill C-59, effective January 1, 2024, have introduced additional rules to prevent misuse and ensure fairness in the tax system.
15. Budget 2024 proposed to increase the LCGE limit to $1.25 million of eligible capital gains. This measure would apply to dispositions that occur on or after June 25, 2024. Indexation of the LCGE will resume in 2026. Proper tax planning is required to ensure the seller can access LCGE.
16. Without access to LCGE, the effective tax rate would be around 34.9%.
17. The meaning of “child” was later expanded to include a niece or nephew of a taxpayer or taxpayer’s spouse/common-law partner, the spouse/common-law partner of a niece or nephew, and the children of a niece or nephew in Bill C-59.
18. The Canadian Federation of Independent Businesses (January 2023), Succession Tsunami: Preparing for a decade of small business transitions in Canada, https://www.cfib-fcei.ca/en/research-economic-analysis/succession-tsunami-preparing-for-a-decade-of-small-business-transitions..
19. Section 69 of the Income Tax Act.
20. The 25% penalty can be avoided through disclosure to the CRA or if certain exclusions apply. Consult your tax advisor(s) for tax advice.